

Cash Balance New Comparability Regulations

Announcement 2003-22

On December 11, 2002, Treasury and the IRS published proposed regulations under §§ 411(b)(1)(H) and 411(b)(2) of the Internal Revenue Code (the “Code”). 67 *Fed. Reg.* 76123. These proposed regulations interpret the statutory age-discrimination rules for all qualified plans, including cash balance pension plans.

At the same time, Treasury and the IRS published proposed regulations under Code § 401(a)(4). The proposed § 401(a)(4) regulations provide that an “eligible cash balance plan” (as defined in the proposed § 411(b)(1)(H) regulations) may not demonstrate that the benefits under the plan do not discriminate in favor of highly compensated employees using the rules for defined benefit plans unless the plan complies with a modified version of the special § 401(a)(4) regulations related to cross-testing by defined contribution plans and certain arrangements involving combinations of defined contribution and defined benefits plans. This restriction on the use of inconsistent testing methods between §§ 411(b)(1)(H) and 401(a)(4) was intended to ensure that plan sponsors could not avoid the “new comparability” rules applicable to a defined contribution plan and those combination arrangements through the use of a cash balance plan (which has a benefit accrual pattern similar to that of a defined contribution plan).

However, comments submitted on the proposed § 401(a)(4) regulations have raised serious concerns about their effect on cash balance conversions. Specifically, comments have indicated that the proposed § 401(a)(4) regulations would make it difficult – or, in certain cases, impossible – for plan sponsors converting long-standing traditional pension plans to cash balance plans to provide different types of transition relief to plan participants. The practices that would be problematic under the proposed § 401(a)(4) regulations include, among others, providing plan participants who meet certain age or service criteria with a “choice” whether to accrue future benefits under the traditional plan formula or the cash balance plan formula; providing such participants, at retirement, the greater of the benefit under the traditional plan formula or the benefit under the cash balance plan formula; “grandfathering” current plan participants under the traditional plan formula; and providing “transition credits” to certain plan participants.

These consequences for plan participants who receive and plan sponsors who provide transition relief in cash balance conversions were not intended. Therefore, Treasury and the IRS will withdraw the proposed § 401(a)(4) regulations.

Treasury and the IRS remain concerned about the potential for plan sponsors to avoid the requirements of the new comparability regulations through the use of a cash balance plan. Treasury and the IRS intend to issue new proposed regulations that will address this specific concern without creating impediments to conversion practices implemented in the interests of fairness to plan participants. Comments are requested on this issue.

Comments may be submitted on or before July 27, 2003, in writing, and should reference Announcement 2003-22. Comments may be submitted to CC:PA:RU (Announcement 2003-22), room 5226, Internal Revenue Service, POB 7604 Ben Franklin Station, Washington, DC 20044.

In addition, comments may be hand delivered between the hours of 8 a.m. and 4 p.m. Monday to Friday to: CC:PA:RU (Announcement 2003-22), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, D.C. Alternatively, comments may be submitted via the Internet at Notice.Comments@irsounsel.treas.gov. All comments will be available for public inspection and copying.